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SUBJECT: SERBIA: PRIVATE BANKS SHARE VIEWS ON FINANCIAL
VULNERABILITIES, BUSINESS CLIMATE

REF: Belgrade 886

SUMMARY

¶1. (SBU) Executives from Serbia's major private banks met with Embassy econoffs on September 4-5 to discuss the country's financial vulnerabilities and overall business climate. The banks voiced strong concerns about Serbia's current account deficit but expressed confidence about continued external financing in the near term. Banks were committed to the Serbian market for the long term, as bank lending continued to be brisk and had not been affected much by the global credit crunch. While the bank executives welcomed the new government's economic agenda, they were downbeat about the recent pension hikes and the lack of fiscal discipline that the government had thus far exhibited. The most important message we received was that the banks were heavily invested in Serbia and were not inclined to rush for the doors in the event of a financial crisis. End Summary.

FINANCIAL VULNERABILITIES: CONCERN, BUT NOT PANIC
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¶2. (U) Serbia's banking sector is dominated by foreign banks, mainly from Austria, Italy, and Greece. Out of 34 banks in Serbia, 20 are majority foreign-owned, 6 are majority domestic-owned, and 8 are majority-owned by the state, according to the National Bank of Serbia's (NBS) latest banking supervision report. The top 10 banks account for 69% of bank assets, while foreign-owned banks account for 75% of bank assets. We met on September 4-5 separately with executives from Societe Generale (France), Piraeus Bank (Greece), Alpha Bank (Greece), and Raiffeisen Bank (Austria).

¶3. (SBU) Everyone we spoke to expressed serious concern about Serbia's current account deficit, estimated to be near 20% of GDP in the second quarter. At the same time, however, they downplayed the likelihood of a crisis or financing difficulties over the next 12 months and were hopeful that continued high growth rates and investment could sustain the needed capital inflows over the near term (Serbia's GDP grew by 7.5% in 2007). High short-term interest rates due to the National Bank of Serbia's (NBS) strict anti-inflation targeting regime were also a factor in drawing in external funding for now and propping up the dinar. Mila Korugic-Milosevic, chief economist at Piraeus, told us that the current account deficit was sustainable if Serbia continued to attract at least $4.5 billion of foreign direct investment (FDI) every year. (Note: At a Foreign Investors Council (FIC) event on September 10 Deputy Prime Minister Dinkic said that the government expected $4 billion in FDI in 2008 and was aiming for $5 billion/yr in the next three years. End Note.)

¶4. (SBU) The banks felt the dinar was overvalued, but views were mixed as to how much of a concern this was. Korugic-Milosevic and Zoran Petrovic, deputy chairman of the managing board at Raiffeisen,

noted that currency appreciation was a feature of transition economies. Countries in Eastern Europe had experienced high inflation and surging capital inflows in the first decade of transition, which drove up the real value of the currency. Serbia, therefore, was in the same position that Central European economies were in 10 years ago. However, Panagiotis Vlasiadis, Alpha Bank Executive Board President, told us privately that the strong dinar could degrade Serbia's already weak competitiveness, observing that only export growth could reduce the economy's financial risks over the next several years.

BANKS COMMITTED TO THE SERBIAN MARKET

¶5. (SBU) All of the banks emphasized that in the event of a speculative attack or a financial crisis, they were heavily invested in Serbia for the long term and had no intention of leaving the country. Goran Pitic, Societe Generale (SocGen) Board of Directors President, said that credit lines would remain open and, perhaps more importantly, that SocGen would keep viewing Serbia as rife with profitable lending opportunities, "even if a year or two of crisis happens." Pitic also quipped that if banks left, "where would they go?" Other countries' banking sectors were "saturated." Piraeus Bank, according to Korugic-Milosevic, had established 47 branch offices in the country (16 in Belgrade) and was making "too much money" to justify pulling out of Serbia.

¶6. (SBU) Petrovic and Vlasiadis unequivocally expressed similar sentiments and mentioned that Serbia and the Western Balkans were strategic, long-term investments for their respective parent banks. Southeastern Europe accounted for 30% of Raiffeisen's foreign business. When we inquired about whether pulling out of the country in the event of a crisis was considered, Petrovic said, "no chance."

Raiffeisen was committed to Serbia's market for the long term, and an occasional market flare-up was the "price you have to pay" to do business overseas. Vlasiadis said humorously that Alpha would "bolt down" the building and ride out any coming storm if necessary. Alpha, like other banks and creditors, would continue to lend, but at higher rates.

BANK LENDING REMAINS ROBUST

¶7. (SBU) The executives told us that they understood the necessity of fighting rising inflation, which was now above 10%, but they all complained about the NBS' credit restrictions, as the central bank had raised rates from the end of December to May from 9.75% to 15.75%. Despite the monetary stringency, their corporate clients could absorb the higher rates, or avoid them by using cross-border loans in euros, and thus lending continued to be quite profitable. Infrastructure, construction, chemicals, food processing, and refinancing were some of the key areas the banks were targeting for growth. The banks also said that the global credit crisis, despite resulting in somewhat higher borrowing costs, had not affected loan volume.

PENSIONS, POPULISM HARM MACROECONOMIC OUTLOOK
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¶8. (SBU) Pitic, Korugic-Milosevic, Petrovic, and Vlasiadis were quite critical of the new Serbian Government's fiscal largesse. They all praised the renewed focus on attracting greenfield investment and tackling infrastructure problems but took a negative view about the recent hike in public pensions (reftel). Pitic said the major risk now for Serbia's business climate was the government's unwillingness to quit populist policies and focus on investor-friendly reform. Vlasiadis predicted that higher pensions would stoke further inflation and perpetuate the NBS' strict monetary stance. Petrovic shared this view and said that the "overall budget is growing too much." The budget revisions for 2008 would send a message about the government's commitment to fiscal discipline. The prospect of pensions at 70% of wages was "totally crazy," according to Petrovic, and he added that he would not be surprised if the Finance Minister resigned if the budget deficit

continued to increase next year.

COMMENT

¶9. (SBU) On balance, the banks were cautiously optimistic about Serbia's near-term economic prospects, but more wary about the economy going into 2010-2011. Bank executives do not believe a financial crisis is imminent, but the country's external vulnerabilities merit serious concern. If the economy continues to grow at 7%-8%, and Serbia continues to draw in sufficient FDI inflows, the economy could boost exports and mitigate the financial risks. If growth slows, an inability to attract greenfield investors, and/or fiscal measures (e.g., more pension increases) that raise the budget deficit and public expenditures, could cut investor confidence and tilt risks to the downside. Our conversations once again came down to greenfield investment and the overall business climate. Everyone agreed that ultimately export-oriented FDI held the key to the country's most pressing economic problems. Prime Minister Cvetkovic, as well as several other ministers, used all the right talking points at the September 10 meeting announcing FIC's yearly recommendations to the government on economic policy. How much progress the new government makes in achieving their goals to build infrastructure, streamline regulations and improve the business climate will ultimately depend on their ability to govern, rather than just campaign for office. The bankers believe there is a window of opportunity for the government to set the economy on a path of sustainable growth. However, without budget restraint, action on legislation and implementation of reforms, macroeconomic pressures could lead to difficulties in the future. End Comment.

MUNTER